Nippon Paint Group INVESTOR DAY 2024
December 2, 2024
Q&A Summary: NIPSEA Group Business Strategy

◆ Questions from Participant A

Q1	Could you give us insights into the business environment and your approaches in Tier 1 and 2 cities compared to Tier 3-6 cities?
A1	We are very dominant in Tier 1 and 2 cities and just as broad splits; the Tier 1 and 2 cities really constitute about 80 percent of our sales today. And we see a big growth potential in the Tier 3-6 cities, which now account for 20 percent of our sales and are growing very rapidly. We understand that for the Tier 3-6 cities, we need a more localized approach with more targeted and differentiated product segments, competing against a different set of local competitors. Over the last three years, as we have pivoted towards the Tier 3-6 cities, we have started to implement structured and organized operations. Additionally, some of the Phoenix dealers and partners are actually local competitors in the past. They have now committed significant resources and are providing us with access to their distribution channels. They are utilizing our brands and product technologies, enhancing our cost competitiveness in the market. Together, we are jointly pursuing and developing market opportunities.

Q2	As a follow-up question, could you provide us with an overview of the Total Addressable Market (TAM) for newly built and refurbishing projects in the Tier 3-6 cities? I understand that the local competitors are very strong in this segment. To further enhance the distribution channel and the brand recognition going forward, what measures are you going to take? How are you going to focus on the paint sales distribution channels, including exclusive distributors, multi-brand and home stores and interior furnishing stores, and how will you increase your market share beyond paint in interior furnishings? In China, unlike in other countries, DIY is not really DIY; it's more akin to B2B. For painters, how are you going to enhance the recognition of your paint brands? I assume that homeowners are not the final decision maker. Could you please elaborate on the branding strategy targeting them separating if possible in Tier 1 and 2, as well as in Tier 3-6 cities?
A2	The Top of Mind of Nippon Paint is 51% across all tiers, all age groups and all products and prices, which shows that we are building on strengths. As you have pointed out, traditional strengths of foreign brands and international brands like Nippon Paint in China has been in the big metros, but what differentiates Nippon Paint from the rest of the international competitors is that we are having a Top of Mind awareness across all these prices, cities, and product sectors. When we decide to shift the focus out of the traditional strongholds of the Tier 1 and 2

	cities, we bring a lot of strength because the Nippon Paint brand is recognized across China. What is important when we go out is not only to enhance the brand but also to build the distribution. The key to winning in the Tier 3-6 cities is to continue maintaining the strong brand awareness through (i) advertising and outreach and (ii) also color leadership. To build the distribution, which is not only putting more boots on the ground, but also to get local partners to work alongside us to quickly build up the speed to market and the penetration and also to ensure that we have the right product portfolio at the right price point, and they can compete in this slightly different local markets. Shown in page 16 of the presentation are some of the dedicated products made available in Tier 3-6 cities. These products are focused on the rural farming areas designed to turn rural properties into beautiful homes. This leads to the head-to-head competition by local competitors. The last point I'd like to make is that although we view China as one market, we recognize that it is actually very diverse. Through our ability to understand and gain insights, we are able to develop slightly differentiated strategies beyond the broad national strategies targeted for this segment. We believe some of these strategies are gaining traction. If you break down the rough proportion, Tier 1 and 2 cities account for 80% of revenue and Tier 3-6 cities account for 20%, that 20% is actually growing very rapidly. However, what is holding us back is our belief that China is currently a market in recovery; it is still in the doldrums. . We're not holding our breath because we believe that even if the property market does turn around, it will likely recover much faster in Tier 1 and 2 cities, with some lag before the Tier 3-6 cities pick up. Therefore, we continue to lay the groundwork by developing our products, building our partnerships, and strengthening our teams. This way, when the market truly picks up in Tier 3-6 cities, we can significantly improve upon the growth rates we are seeing today.

◆ A question from Participant B

Q1	You explained the strength and innovations happening in the markets. I may be short sighted but how are you controlling the costs for marketing, innovation and branding that you've just mentioned? I believe these efforts are made to enhance your strength as a marketer. However, as reflected in the September financial results, there are times when you need to control marketing costs depending on the revenue situation. When you increase or decrease marketing expenses, how you decide those timings? There are also long-term marketing efforts, so what are the standards for deciding whether to accelerate or apply the brakes in NIPSEA Group and DuluxGroup? You have excellent management, but from an investor's point of view, it would be reassuring if you could provide clear standards on how you

	decide on marketing expenditures.
A1	When you saw my charts about reaching new customers, participating in exhibitions, and engaging new stakeholders, you might be concerned that our marketing expenses could go into overdrive. What is important for us is our belief in the market and learning from the past three years in China, as well as from our competitors. Over the last three to four years, there has been a significant shift away from large national property developers toward different segments. Some competitors, traditionally strong in the property sector, have pivoted to commercial sectors where short-term growth is evident. There is strong price competitiveness in the B2C market, which raises concerns among our investors. In a competitive market, costs might increase due to higher marketing budgets, or prices might be cut to gain market share. This is the reality in China today. At Nippon Paint China, we focus on maintaining cost competitiveness. Our stronghold is retail emulsion, which constitutes close to 50% of our business and maintains high double-digit margins. However, our overall margins have decreased quarter-on-quarter, driven by changes in product mix including a larger volume of lower-priced products. Additionally, there is a shift in our product mix because some suppliers are now looking to us to provide raw materials. This results in higher trading revenue from finished and semi-finished goods, which are not paint products. Moreover, the decorative non-paint segments of our business, such as putty and accessories, are growing, further changing the paint/non-paint product mix. Despite these shifts, we remain confident by focusing on our profitable retail emulsion segment, where margins have not changed year-on-year. We ensure the right mix of brand investments by maintaining cost efficiencies in other areas of the business. This includes controlling formulation costs, buying raw materials at the best prices, optimizing logistical efficiency, and keeping our SG&A controlled. Cost efficiency is multi-faceted and brand building and marketing only represent two to three percent of the entire cost structure.

◆ A question from Participant C

Q1	In your paint and coatings business, and particularly in NIPSEA Group, you have high stability and profitability. Currently, there are various risk factors in the business environment. Could you explain what measures are taken to enhance resilience, reduce costs, and improve efficiency? Additionally, are you planning, or do you see any rooms for any restructuring or structural reforms within NIPSEA Group?
A1	Earlier, I discussed the chart showing the compounded growth rates of both NIPSEA China and NIPSEA Except China for operating profit and margins over the last three years. From 2021 to 2023, the world was beset with the COVID,

	and in China, particularly with the extreme pressures put on everyone by the zero COVID policy. We faced supply disruptions, the cost of the wars, and raw material price volatility. These were risks we had to manage. We believe there is no one-size-fits-all approach to mitigating risks, which aligns with our management strategy for NIPSEA Group and the larger Nippon Paint Group. We listen carefully to our competent local management, granting them with autonomy and independence while providing group assistance. This decentralized approach helps mitigate risk, ensuring no single unit can significantly affect the entire Group. This risk management approach is hardwired even into new partner companies. As Mr. Patrick Houlihan mentioned, when we bring in new teams, they quickly adapt and show progress. Our mantra is MSV (Maximization of Shareholder Value), focusing on making money and creating shareholder value. We recognize potential global discontinuities, such as technological and trade decoupling, which are already happening to some extent. We are structured to withstand such challenges. For example, NIPSEA China and the Malaysia Group within NIPSEA Group operate distinctly apart, including separate IT systems and different approaches to stakeholder interactions. This structure prepares us for possible decoupling scenarios. Regarding structural reforms, we are always changing and flexible. For example, three years ago, we decided to divest our India operations and European auto operations due to their risk to the Nippon Paint Group. After two years, we found that the India businesses now meet our criteria, so we bought them back. The European auto business is still under observation, but we maintain connections with European Auto OEMs through this relationship. We continuously adapt based on what aligns with our MSV philosophy.

◆ Questions from Participant D

Q1	My question has two parts. First, we are seeing more integration between construction materials and paints. Could you elaborate on what has happened in the past five to ten years? Previously, construction materials and paints were two separate categories with different competitors, but now we see more integration and competition in the same categories. What is driving this change? Second, could you elaborate on the competition in India, where new entrants are entering the dominant decorative paints market? Could this happen in China or Malaysia in the future? If not, what are the barriers to entry in these markets?
A1	The first part of your question is about the integration of paint and coatings with construction chemicals. Traditionally, these were separate categories with different competitors. However, in the past 5 to 10 years, we've seen players from the paint and coatings sector move into construction chemicals, and vice versa. For example, in India, there is a company that is very strong in sealants and adhesives and construction chemicals, and is now entering paint and

coatings. Similarly, in China, a company known for waterproofing is also moving into paint and coatings.

So even in Nippon Paint Group five years ago before we actually put forth even a wider Asset Assembler approach, we actually thought in terms of a Paint++ approach. This strategy leverages our expertise in paint and coatings, utilize common chemistry, distribution channels, and market insights. DuluxGroup's integration into our fold further strengthened our capabilities, particularly with their strong SAF segment and the Selley's brand.

In China and Malaysia, we've expanded capabilities. We acquired Vital Technical in Malaysia and built up our dry mix mortar and putty businesses. This Paint++strategy lowers risk by building on our existing strengths.

Five years ago, when we first considered the Paint++ strategy, the SAF segment was particularly attractive. We pivoted and asked the group to focus on growing SAF, driven by the integration of the DuluxGroup into our fold. The DuluxGroup brought a strong SAF segment, underpinned by the Selleys brand, which we then integrated into the NIPSEA Group. This led to the development of capabilities in China, and in Malaysia, we acquired Vital Technical in the SAF area. We subsequently acquired CMI, building up the dry mix, mortar, and putty segments.

The Paint++ approach is seen as a lower-risk strategy because it leverages our strengths in chemistry, distribution channels, and the support of the DuluxGroup. While we do consider further expansion into construction chemicals, it involves moving slightly away from our core chemistry and channels. For example, in China, we've developed construction chemicals adjacent to the paint and coatings business by leveraging existing distribution channels. However, some paint and coatings distributors have struggled to adapt, leading us to establish dedicated segmental dealers specializing in areas like adhesives and waterproofing. This diversification increases our market access.

In summary, the two sectors are converging, and we are learning and investing in both acquisitions and market-building efforts.

Regarding competition, India has seen the entry of two to three significant new players in the organized market, with 2024 being their first year of market activity. This will intensify competition. However, the NIPSEA Group has a smaller presence in India, making us less affected. If a similar scenario were to occur in China or Malaysia, the impact would differ. In China, the market is consolidating, and the traditional customer base is changing, making it less likely for new entrants without a background in paints and coatings to succeed. The competition is more likely from local Chinese players expanding their market presence.

In Malaysia, the risk of new entrants is lower due to the diverse dynamics of the nine separate countries and regions within the group. Each must be treated differently.

Let me give you an example that is quite positive. We entered Pakistan in 2006, initially focusing on the decorative sector, where we experienced good

	growth. However, today, the automotive sector is our major growth area. Currently, we hold approximately 80-85 percent of the market share in automotive parts. This success is due to our ability to capitalize on the opportunity created when a major partnership in the market dissolved, leaving a significant void. This rapid growth demonstrates our ability to capitalize on market opportunities With strong support from our Japanese colleagues, we were able to increase our market share from around 15 percent to over 80 percent in just 18 months. This might raise concerns about what could happen if a similar situation occurred for Nippon Paint. Could a competitor step in and capture a large market share? While it's possible, we are prepared to defend our position vigorously and will not simply allow competitors to take over our market share.

Q2	As a follow-up, how do you look at the B2B business in China? I believe investors have considerable confidence in your B2C business strategies and track record. However, for the B2B sector, we see competitors exiting the larger B2B segment, including the housing developer related businesses focusing more on the factory, schools and smaller businesses. What is your strategy for housing development-related businesses? Do you see any signs of bottoming out?
A2	I have a chart that indicates how we are adapting to the new market environment in China. Today, we target three groups: the public sector, businesses, and consumers. Your question focuses on the public sector and business, which we see as new addressable markets. Before 2020, our primary focus was on large property developers, which was a thriving market at the time and a necessary area for us to compete in. However, that market has since declined. Since 2020, we have taken the opportunity presented by this market hiatus to strengthen our capabilities. We have started to explore the public sector, including new district rejuvenation and new factories. In the business sector, we are addressing specific needs in the electronics, food processing, and pharmaceutical industries. Each sector has unique requirements, and we are building solutions to meet these needs. It has been both enlightening and humbling that we have not overlooked this substantial market. The downturn from 2020 awakened us to opportunities we had neglected. In several charts during my presentation, I showcased our efforts over the past three years, which are beginning to show success as we attract new customers. Although we are growing from a lower base, we believe we can compensate for the downturn in the large property developer market. Despite a significant reduction in our TUB business, which catered largely to big property developers, NIPSEA China has not seen a decline in revenue. We have offset this with other revenue streams.

	We hope this transition will give us enough time to grow and succeed in these new segments.

◆ A question from Participant E

Q1	In NIPSEA, as a foreign brand in China, do you recognize any potential future risks? SKSHU is a completely local brand, whereas your brand is seen as one originating from Singapore or Japan. Are there any political risks associated with this, and how are you hedging against them? This could be considered a Black Swan event, and it may be difficult to predict, but do you see any signs of such risks for a foreign brand? I recognize the strong brand power you have, but I would appreciate your insights on this matter.
A1	Since we entered China in 1992, the risk of being a foreign brand has always been present. It is difficult to argue whether this risk is higher or lower nowadays. Since 1992, we have always projected ourselves in the Chinese market with our Chinese name, LiBang, rather than Nippon Paint. When consumers think of our brand, LiBang is at the top of their minds. We have taken great care to present ourselves as an international brand rather than solely a Japanese brand. This does not mean we shy away from our Japanese heritage. In fact, in our automotive business, we leverage our Japanese heritage significantly. However, we cannot entirely discount the possibility of a Black Swan event. To mitigate this risk, we position ourselves as an international brand deeply connected with China. At the recent China International Import Export (CIIE), the theme was “In China, for China.” We showcased products developed in collaboration with Chinese partners, enhancing them with global expertise. One example is our photocatalytic product designed to address air quality issues in Chinese cities. This technology was co-developed with two Chinese universities. We showcased this product prominently at our booth during the CIIE. The response was overwhelmingly positive; many provincial administrators who visited our booth expressed a strong interest in the product. They were keen to take samples back with them to explore how they could integrate it into their local budgets and initiatives. What particularly appealed to these administrators was the fact that our company, despite being international, works very closely within China to develop products specifically customized for the Chinese market. They appreciated that we understand China's unique needs and produce everything locally, "In China, for China." This approach not only underscores our commitment to the Chinese market but also enhances our credibility and trustworthiness as a partner in local development projects. By aligning our product development and production closely with local requirements and collaborating with local institutions, we aim to mitigate

	potential geopolitical risks and reinforce our position as a valuable contributor to China's growth and innovation. This approach resonates with provincial administrators who visited our booth and expressed interest in integrating such innovations into their budgets. They appreciated seeing an international company working closely with China to develop customized products. By focusing on China-specific needs and producing locally, we aim to mitigate the potential impact of Black Swan event.

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